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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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## FORM 10-Q

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 1992

OR

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 2-50895

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## PACIFICORP FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

| STATE OF OREGON | 93-0369681 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS employer Identification Number) |
| 111 S.W. Fifth Avenue<br>Suite 2800<br>Portland, Oregon<br>(Address of principal executive offices) | 97204<br>(Zip Code) |

Registrant's telephone number, including area code: (503) 222-7920

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO __

At August 11, 1992, there were 179,005 shares of the registrant's $10 par value common stock outstanding.

Registrant meets the conditions set forth in General Instruction H (1) (a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format.

PACIFICORP FINANCIAL SERVICES, INC.
AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements

## PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
### Condensed Consolidated Balance Sheets
(In Thousands of Dollars)

| | June 30, 1992 | December 31, 1991 |
|---|---|---|
| | (Unaudited) | |
| **ASSETS** | | |
| Cash and cash equivalents | $ 106,015 | $ 34,172 |
| Investment in financing assets: | | |
| Net investment in finance receivables | 541,553 | 570,902 |
| Less allowance for credit losses (Notes 2 and 6) | 45,578 | 15,029 |
| | 495,975 | 555,873 |
| Net investment in leveraged leases | 357,587 | 350,829 |
| Less allowance for credit losses (Notes 2 and 6) | 9,600 | -- |
| | 347,987 | 350,829 |
| Net investment in equipment under operating leases | 229,513 | 288,823 |
| Net investment in other financing assets | 5,950 | 30,214 |
| Net investment in financing assets | 1,079,425 | 1,225,739 |
| Real estate properties, net | 222,985 | 235,812 |
| Investments in and advances to affiliates | 3,282 | 3,084 |
| Accrued interest and other receivables | 26,578 | 31,132 |
| Off lease equipment held for sale or lease (Notes 2 and 5) | 92,950 | 102,604 |
| Intangible assets (Note 2) | -- | 38,242 |
| Other assets (Note 2) | 43,757 | 47,759 |
| | $1,574,932 | $1,718,544 |
| **LIABILITIES AND STOCKHOLDER'S EQUITY** | | |
| **LIABILITIES** | | |
| Short-term notes payable | $ 438,012 | $ 439,664 |
| Income taxes payable and other liabilities (Note 3) | 357,427 | 394,096 |
| Payable to parent (Note 4) | 46,861 | 30,336 |
| Long-term debt | 542,719 | 574,279 |
| Total liabilities | 1,385,019 | 1,438,375 |
| COMMON STOCKHOLDER'S EQUITY (Notes 2 and 4) | 189,913 | 280,169 |
| | $1,574,932 | $1,718,544 |

See notes to condensed consolidated financial statements.

PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(In Thousands of Dollars)
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 1992 | 1991 | 1992 | 1991 |
| Net financing revenues (Note 2) | $ 33,737 | $ 32,377 | $ 50,991 | $67,247 |
| Net real estate revenue | 7,062 | 4,920 | 13,792 | 8,833 |
| Net manufacturing revenue | 8,230 | 7,921 | 12,996 | 11,948 |
| | 49,029 | 45,218 | 77,779 | 88,028 |
| Interest and debt expense | 20,124 | 22,778 | 39,360 | 46,558 |
| | 28,905 | 22,440 | 38,419 | 41,470 |
| Other operating expenses: | | | | |
| Salaries and related expenses | 5,380 | 5,484 | 10,498 | 11,761 |
| Other general and administrative (Note 3) | 5,910 | 4,804 | 32,794 | 10,732 |
| Valuation charges (Note 2) | — | — | 49,055 | — |
| Provision for credit losses (Note 2) | 8,858 | 6,088 | 58,146 | 7,454 |
| Real estate development and property rental expense (Note 2) | 5,141 | 2,511 | 22,987 | 4,563 |
| Manufacturing expenses | 7,915 | 6,866 | 15,276 | 12,440 |
| Total expenses | 33,204 | 25,753 | 188,756 | 46,950 |
| Loss from affiliated partnerships | — | (182) | — | (306) |
| Minority interest | 193 | — | 595 | — |
| Loss before income taxes | (4,106) | (3,495) | (149,742) | (5,786) |
| Income tax benefit | (5,389) | (4,034) | (49,486) | (8,844) |
| Net income (loss) | 1,283 | 539 | (100,256) | 3,058 |
| Preferred stock dividends | — | 478 | — | 1,045 |
| Income (loss) available to common stockholder | $ 1,283 | $ 61 | $(100,256) | $ 2,013 |

See notes to condensed consolidated financial statements.

# PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands of Dollars)
(Unaudited)

| | Six Months Ended June 30, 1992 | 199* |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Net income (loss) | ($100,256) | $ 3,058 |
| Adjustments for items not affecting cash: | | |
| Depreciation | 61,761 | 53,313 |
| Amortization of goodwill and intangibles | 745 | 1,260 |
| Provision for credit losses | 58,146 | 7,434 |
| Provision for deferred income taxes | (30,719) | 4,869 |
| Minority interest | (595) | -- |
| Valuation charges | 49,055 | -- |
| Other | 9,844 | 4,899 |
| | 47,981 | 75,773 |
| **Cash Flows From Investing Activities:** | | |
| Finance receivables: | | |
| Finance receivables funded | (43,349) | (151,886) |
| Proceeds/payments | 90,400 | 185,261 |
| Equipment under operating leases: | | |
| Purchase of assets | (16,289) | (28,166) |
| Proceeds from sale of assets | 12,787 | 5,479 |
| Leveraged leases: | | |
| Proceeds from sale of assets | -- | 25,861 |
| Payments received representing principal | 3,698 | 2,539 |
| Other | 405 | (268) |
| Real estate: | | |
| Purchase of assets | (4,394) | (21,755) |
| Proceeds from sale of assets | -- | 10,327 |
| Other | 43 | (127) |
| Other investments sold | -- | 2,899 |
| Investments in and advances to affiliates | (329) | (3,196) |
| | 43,972 | 18,968 |
| **Cash Flows From Financing Activities:** | | |
| Net decrease in short-term debt | (1,652) | (20,833) |
| Net increase in payable to parent | 25,664 | -- |
| Long-term debt: | | |
| Issued | 2,000 | 46,250 |
| Repaid | (55,221) | (62,215) |
| Non-recourse debt: | | |
| Issued | 66,966 | 38,755 |
| Repaid | (46,007) | (43,869) |
| Leveraged lease non-recourse debt: | | |
| Repaid | (10,860) | (31,895) |
| Stockholder's equity: | | |
| Dividends paid on common stock | -- | (3,621) |
| Dividends paid on preferred stock | -- | (1,065) |
| Return of capital | -- | (4,100) |
| | (19,110) | (81,779) |
| Increase in Cash and Cash Equivalents | 71,843 | 16,558 |
| Cash and Cash Equivalents Beginning of Year | 34,172 | 25,173 |
| Cash and Cash Equivalents End of Quarter | $106,015 | $ 41,731 |

See notes to condensed consolidated financial statements.

(continued)

## PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands of Dollars)
(continued)
(Unaudited)

| | Six Months Ended June 30, 1992 | 1991 |
|---|---|---|
| **Supplemental disclosures of cash flow information** | | |
| Cash (paid) received during the period for: | | |
| Interest expense | $(76,393) | $(72,720) |
| Tax benefits received | 14,663 | 20,389 |
| **Significant non-cash financing activities** | | |
| Conversion of junior subordinated note held by parent to equity | 10,000 | -- |
| Exchanged of short-term note payable to parent for long-term note | 46,000 | -- |

See notes to condensed consolidated financial statements.

PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands of dollars)
(Unaudited)

## 1. Basis of financial statements

The information presented in the condensed consolidated financial statements is unaudited, but includes all adjustments, consisting of only normal recurring accruals (except as described in Notes 2, 3, and 4), which management of the Company considers necessary for a fair presentation of the results of such periods. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. Reclassifications from prior years for certain amounts have been made to conform with the current year method of presentation. These consolidated financial statements should be read in conjunction with the financial statements and related notes included in the Company's 1991 annual report on Form 10-K.

## 2. Valuation charges

The Company and its parent, PacifiCorp Holdings, Inc. ("Holdings") previously known as Inner PacifiCorp, Inc., have been experiencing restricted access to the commercial paper and medium-term note markets. In order to improve this situation, the Company and Holdings underwent an extensive review of their financial plans during the first quarter of 1992. The purpose of the review was to develop a financial plan for each company with the goal of improving the credit ratings for both companies, which are currently BBB-/Baa3. Concurrently, PacifiCorp, Holdings' parent, announced that a part of its strategic direction is management's intent to reduce the Company's assets to no more than ten percent (10%) of PacifiCorp's consolidated total assets, which were $13.1 billion at June 30, 1992. The Company has designed its plan (the "Plan") consistent with PacifiCorp's strategic direction and the Company's desire to improve financial results and generate cash through accelerated disinvestment of both underperforming and non-performing assets. The Plan anticipates generating cash and reducing recourse debt by selling certain of these assets, and continuing with plans to limit the size of the computer leasing portfolio and expand the Company's nonrecourse financing sources. The Plan represents a change in the Company's intent with respect to the timing of the realization of certain asset values, given that the disposition process is being accelerated into the current unsettled market for certain financial services investments.

The Company has estimated the effect of implementing the Plan on its asset valuations, and has recorded various adjustments to decrease the affected asset values to net realizable value given their disinvestment in the current unsettled markets. The various charges related to the Plan are included in the Company's six months ended June 30, 1992 condensed consolidated statement of operations as follows:

| | |
|---|---|
| Charge to net financing revenue | $10,000 |
| Provision for credit losses | 48,400 |
| Real estate development and property rental expense | 13,000 |
| Valuation charges | 49,055 |
| Income tax benefit | (31,368) |
| After-tax total | $89,087 |

As a result of the Plan, the Company may be generating fewer opportunities to release or remarket computer equipment as it comes off lease. Thus, the charge to net financing revenue represents a $10,000 reduction of its investment in computer operating leases. The additional provision for credit losses reflects management's assessment of the estimated reduction in net realizable value from direct financing residuals, troubled loan accounts, and the underlying credit quality of leveraged lease accounts, as a result of implementing the Plan and accelerating liquidation or resolution of these accounts. The charge to property development expense is similarly related to a reduction in net realizable value of the Portland, Oregon properties held by the Company's wholly-owned subsidiary Pacific Development, Inc. ("PDI"), given management's intent to accelerate the disposal of these assets. Valuation charges consist of (i) $37,455 related to goodwill and other intangible assets (primarily associated with the Company's Computer Leasing Unit), (ii) $8,600 related to off

lease aircraft held for sale, and (iii) $3,000 related to other assets which the Company anticipates it will sell on an accelerated basis as part of the Plan.

## 3. Contingent liability charge and settlements

During 1991, International Business Machines, Inc. ("IBM") initiated litigation against a major competitor of the Company's Computer Leasing Unit that involved allegations by IBM that certain practices involving mainframe memory constitute unfair business practices. In addition, IBM filed a separate lawsuit against the competitor related to certain leasing practices. The Company's competitor continues to vigorously contest the IBM claims. During the first part of 1992, the Company engaged in discussions with IBM regarding certain of these practices as they relate to the Company. In the first quarter of 1992, the Company accrued an estimated cost of resolving the matter with IBM, including the cost of replacing certain units of memory. During the second quarter of 1992, the Company resolved the matter at a cost within the parameters of the first quarter accrual.

In January 1990, the Company sold the capital stock of a subsidiary that had been acquired as the result of a collateral repossession. The purchase price was subject to certain adjustments related to working capital as measured at the closing date. The Company and the buyer reached an agreement as to these adjustments in April 1992 with approximately $1,300 being paid by the Company in May, 1992 related to such adjustments.

## 4. Transactions with Holdings

On March 31, 1992, Holdings contributed the Company's previously outstanding $10,000 10.42% Junior Subordinated Medium-Term Note, due January 4, 1994, to the Company. This contribution reduced the Company's long-term debt and increased stockholder's equity by $10,000.

Also on March 31, 1992 the Company exchanged its $46,000 short-term obligation to Holdings for a $46,000 note due March 31, 1994. The note bears interest at a floating rate equal to Holdings' average daily cost of funds plus 3/8% per annum.

## 5. Off lease equipment held for sale or lease

Off lease equipment held for sale was as follows:

| | June 30, 1992 | December 31, 1991 |
|---|---|---|
| Computer equipment: | | |
| Inventory | $ 19,524 | $ 24,660 |
| Lease-in-process | 14,853 | 8,156 |
| Aircraft | 57,671 | 68,528 |
| Other | 902 | 1,260 |
| | $ 92,950 | $102,604 |

Lease-in-process represents equipment that is being assembled or packaged for a pending lease contract.

## 6. Allowance for Credit Losses

| | |
|---|---|
| Balance at beginning of year | $15,029 |
| Provision charged to expense | 58,146 |
| Less losses charged off, net of recoveries | (17,997) |
| Balance at end of period | $55,178 |

## 7. Income taxes

Income taxes are not provided on a separate entity basis. The Company files its tax return on a consolidated basis with its parent, Holdings. The Company has an arrangement with Holdings pursuant to which the Company is compensated for certain tax benefits generated, regardless of when Holdings can utilize these benefits, provided that the Company manages its generation of such tax benefits within guidelines established by Holdings. Many of the transactions the Company enters into would not be as advantageous if contemporaneous compensation for tax benefits generated were not made to the Company. Compensation earned from Holdings for tax benefits is treated as a reduction to the Company's current income tax provision.

The Company has been under examination by the Internal Revenue Service (the "IRS") for the years 1985 and 1986. In November 1990, the IRS issued a revenue agent's report in which it proposed adjustments that could substantially increase the tax for these years. The Company has filed a protest on the significant proposed adjustments. The final resolution of these adjustments cannot presently be determined but, in the opinion of management, resolution of these adjustments will not have a material effect on the Company's consolidated financial position or results of operations.

## 8. Contingencies

In December 1986, the Company, through one of its subsidiaries, invested as an equity participant in the sale and leaseback of Springerville Unit No. 1, a coal-fired steam electric generating facility in Springerville, Arizona ("Plant"), with Century Power Corporation ("Century") as the seller/lessee. The Company owns an approximate 10 percent undivided interest in the Plant, the balance being owned by other equity participants.

Tucson Electric Power Company ("Tucson") purchases the output of the Plant pursuant to a 28-year power sales contract signed in 1986 with Century (the "Power Sales Contract"). These payments are used by Century to meet its lease obligations to the equity group. Through 1989, a portion of the output of the Plant was sold to San Diego Gas and Electric Company ("SDG&E"). In February 1989, SDG&E and the Arizona Corporation Commission (the "ACC") filed separate complaints (the "FERC Proceeding") with the Federal Energy Regulatory Commission (the "FERC") in which they asserted, among other things, that the demand charges pursuant to the Power Sales Contract were unjust and unreasonable. The ACC complains that the inclusion of the lease payments in the rate formula results in excessive rates for service from the Plant as the charges are determined by reference to the amount for which the Plant was sold by Century in its sale and leaseback arrangement, which was in excess of its depreciated book value. SDG&E asked the FERC to reduce Century's rates by amortizing against rates the gain from the sale of the Plant. Tucson is precluded from challenging Century in the FERC Proceeding under the terms of the Power Sales Contract. However, Century has stated to the FERC that the entry of an order granting the requested relief would have very serious consequences, which might result in Century's bankruptcy.

Tucson has continued to suffer extreme financial distress. In order to facilitate the financial restructuring of Tucson outside of bankruptcy court, a payment moratorium was imposed by Tucson on all debt, facility leases and capacity charges. In July 1991, three lessors of facilities to Tucson filed involuntary bankruptcy petitions against Tucson to protect them from action threatened by the project's nonrecourse lenders. Immediately thereafter, three of the equity participants in the Springerville project, not including the Company, filed similar petitions against Century. Tucson was granted significant rate relief by the ACC but, in order to be effective, the involuntary petitions were required to be dismissed by December 31, 1991. This requirement for dismissal of involuntary petitions was achieved, allowing Tucson to implement rate relief as granted by the ACC.

While agreements are subject to definitive documentation, Tucson reached agreements with its various creditors, including the equity participants, within the required time frame. The specific agreement in principle reached by Tucson with the equity participants requires that (i) Tucson assume the Springerville lease at substantially reduced rents, which escalate over time, (ii) Tucson be released from certain indemnities given Century and the equity participants, and (iii) Tucson issue, at no cost to the equity participants, common stock representing 10% of Tucson's total outstanding shares to the

equity participants, plus warrants with an initial exercise price of $4.00/share representing an additional 7.5% interest in Tucson.

As conditions precedent to obtaining a definitive agreement, the ACC must (i) approve the settlement, (ii) approve the restructured lease, and (iii) terminate the FERC Proceeding against Century.

The Company accounts for its investment as a leveraged lease. At June 30, 1992, the Company's investment, net of deferred taxes, was approximately zero. As a result, under leveraged lease accounting, no earnings were expected or recognized in the current period. Should the above agreement not become effective and the Company sustain a total loss by abandoning its investment, the Company could experience an after-tax loss of up to $17.6 million.

While the Company believes that this agreement will ultimately become effective, it remains subject to the conditions cited above. However, given the terms of the proposed agreement, the Company does not expect to realize a material loss associated with this transaction.

## 9. Subsequent Event

On July 1, 1992, the Company resolved its remaining contingent obligation with respect to certain put provisions contained in three partnership agreements that were part of the original acquisition documentation in 1987. For cash consideration of $25,664, the Company increased its ownership interest to 100% from 51.01% in the Lloyd Center Tower Partnership, Ltd., Lloyd Building Partnership, Ltd., and Lloyd Five Hundred Building Partnership, Ltd.

Item 2. PACIFICORP FINANCIAL SERVICES, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS
(In Thousands of Dollars)

Registrant meets the conditions set forth in General Instruction H(1)(a) and (b) of form 10-Q and is therefore filing this form with the reduced disclosure format.

**SIX MONTHS ENDED JUNE 30, 1992 COMPARED TO 1991**

For the six months ended June 30, 1992, net loss was $100,256, as compared to net income of $3,058 earned in the same period in 1991. This decrease is primarily attributable to charges resulting from implementation of the Plan, as stated in the Notes to Condensed Consolidated Financial Statements, and under the caption "Liquidity and Capital Resources".

| Selected Financial Data For the Six Months Ended June 30, | 1992 | 1991 | Increase (Decrease) | % |
|---|---|---|---|---|
| Average net investment in finance receivables | $ 567,531 | $ 719,959 | $ (152,428) | (21)% |
| Less average allowance for credit losses | (39,663) | (22,956) | (16,707) | 73 |
| | 527,868 | 697,003 | (169,135) | (24) |
| Average investment in leveraged leases | 348,377 | 311,682 | 36,695 | 12 |
| Average deferred taxes on leveraged leases | (272,981) | (247,721) | (24,360) | 10 |
| Average net investment in leveraged leases (1) | 76,296 | 63,961 | 12,335 | 19 |
| Average net investment in equipment under operating leases | 256,172 | 334,919 | (78,747) | (24) |
| Average other finance assets | 10,038 | 41,881 | (31,843) | (76) |
| Average net investment in finance assets | $ 870,374 | $ 1,137,784 | $ (267,390) | (24)% |
| Net financing revenues | $ 50,991 | $ 67,247 | $ (16,256) | (24)% |
| Average non-accrual financing assets (1) | $ 79,112 | $ 117,697 | $ (38,585) | (33)% |
| As a % of average total assets | 4.99% | 6.84% | | |
| End of period non-accrual financing assets (1) | $ 55,002 | $ 98,642 | $ (43,640) | (44)% |
| As a % of quarter-end total assets | 3.49% | 5.74% | | |

(1) Leveraged leases are shown net of applicable deferred taxes since this is the basis on which revenues are recognized under leveraged lease accounting rules.

Net financing revenues decreased $16,256 or 24% from the first half of 1991. This decrease includes the effect of a $10,000 reduction of computer lease residuals, representing management's view that the implementation of the Plan may reduce

opportunities of the Company to release or remarket computer equipment as it comes off lease (see Note 2 to the Company's condensed consolidated financial statements), partially offset by gains on certain nonrecurring sales of equipment ($3,582) by the Company's Computer Leasing Unit. Additional decreases were experienced as a result of the continued decline in average finance assets, which declined 20% prior to the effects of implementation of the Plan.

Partially negating these decreases are the recognition of $3,006 in deferred interest on a loan restored to accrual status, as well as other reductions in interest foregone as a result of a 33% decrease in average nonaccrual finance assets. Due to the decline in nonaccrual finance assets, interest income foregone that would have been recorded under contractual terms was $4,338 for the current six months as compared to $8,371 for the same period in 1991. At June 30, 1992, non-accrual finance assets were $55,002 or approximately 3% of total assets, down from $78,688 and 5% at December 31, 1991. The decrease in nonaccrual accounts is primarily the result of restoring to accrual status a loan to a wood products company mentioned above, and the write off of $16,500 in loans to a builder of residential homes located predominantly in the northeastern United States.

During the first half of 1992, the net investment in finance assets decreased $146,314 (12%) from $1,225,739 at December 31, 1991 to $1,079,425 at June 30, 1992. This decrease was primarily due to the various charges associated with the Plan and the runoff of existing portfolios in the ordinary course of business.

Net real estate revenues increased $5 million or 56% from the first half of 1991 primarily due to the Company obtaining a majority ownership interest in certain real estate partnerships necessitating 100% consolidation of revenues beginning in July, 1991. The Company was contingently obligated to purchase the other partners shares as a result of certain put provisions contained in four limited partnership agreements. On July 1, 1992, the Company resolved its remaining preexisting contingent obligations with respect to these limited partnership agreements by purchasing the other partners' share of three limited partnerships for $25,664.

The Company's manufacturing subsidiary, Vermont Castings, Inc. ("VCI"), is the recognized domestic market leader in the production of wood burning stoves and also produces gas and pellet stoves and accessories. Net manufacturing revenue increased $1,048 or 9% from the first half of 1991. This increase resulted from a combination of increased sales of accessories as a result of the Wonderfire acquisition in the fourth quarter of 1991, a price increase effective the second quarter of 1991, and a shift in sales mix to the higher priced finished products. This increase was partially offset by reduced shipments of stove units as compared to the prior year. Historically, VCI's business is seasonal, with the majority of revenues occurring during the last half of the calendar year.

Interest and debt expense was $39,360 for the first half of 1992 compared to $46,558 in the first half of 1991, a 15% decrease. Of the $7,198 reduction in interest expense, $9,000 (85%) was due to lower average interest rates (7.38% in 1992 compared to 9.06% in 1991), and $3,000 (37%) was due to lower levels of net assets financed. These beneficial changes were offset by the $2,000 (22%) effect of higher average leverage and $2,743 from the termination of an interest rate hedge arrangement, the cost of which is expected to be offset in future periods through lower borrowing rates.

Salaries and related expenses decreased $1,263 or 11% from the first half of 1991. The Company's average nonmanufacturing employee base declined from 378 for the first half of 1991 to 295 in 1992, a reduction of 22% as a result of the staff reductions that were implemented in the third quarter of 1991. The savings from these reductions were partially offset by a pension adjustment, based upon updated actuarial data, of $826 in 1991.

Other general and administrative expenses increased $22,062 from the first half of 1991. This increase is primarily due to the accrual of an equipment restoration reserve in the Company's Computer Leasing Unit. During 1991, International Business Machines, Inc. ("IBM") initiated litigation against a major competitor of the Company's Computer Leasing Unit that involved allegations by IBM that certain practices involving mainframe memory constitute unfair business practices and a separate lawsuit related to certain leasing practices. The Company's competitor continues to vigorously contest the IBM claims. During the first part of 1992, the Company engaged in discussions with IBM regarding certain of these practices as they relate to the Company. In the first quarter of 1992, the Company accrued an estimated cost of resolving the matter with IBM, including the cost of replacing certain units of memory. During the second quarter of 1992, the Company resolved the matter at a cost within the parameters of the first quarter accrual. Other nonrecurring general and administrative charges include

approximately $1,300 which was paid upon resolution of certain purchase price adjustments related to the sale of the common stock of a subsidiary of the Company, originally acquired as the result of a collateral repossession in 1989, and $1,072 of costs were accrued in anticipation of the Company relocating its principal executive offices into one of its own buildings.

Valuation charges of $49,055 were recorded in the first half of 1992 as a result of the Plan. These valuation charges consist of (i) $37,455 related to the write off of goodwill and other intangible assets, primarily associated with the Company's Computer Leasing Unit whose level of operations will be decreased prospectively, (ii) $8,600 related to off lease aircraft held for sale in the current unsettled aviation marketplace, and (iii) $3,000 related to other assets which the Company anticipates it will dispose of on an accelerated basis under the Plan.

The provision for credit losses has increased $50,692 from $7,454 for the first half of 1991. This increase reflects management's assessment of (i) the implementation of the Plan on the net realizable value of finance receivables given the current market, and (ii) its increasing concern regarding the underlying credit quality of certain of its aviation customers, given the continuing weak industry conditions and management's continuing assessment of the collectibility of other finance receivables. A corresponding increase is reflected in the allowance for credit losses, offset by the write off of $16,500 in loans to a builder of residential homes previously mentioned.

Real estate development and property rental expense increased $18,424. This increase includes a provision of $13,000 for the effect of the Plan, which includes a significant disinvestment of the Company's Portland, Oregon real estate properties in the current illiquid real estate climate. The remaining increase is a result of the Company's acquisition of the other partners' share of certain real estate partnerships in July 1991, as mentioned above, necessitating consolidation of 100% of the real estate development and property rental expenses of the acquired partnerships.

Manufacturing expenses have increased $2,836 or 23%. This increase is due to a combination of (i) the acquisition of Wonderfire and the inclusion of its operating expenses, and (ii) increased costs as VCI continues to develop the manufacturing process for its new gas and pellet products.

Income tax benefit increased $40,642 as a result of the higher pre-tax loss.

The Company paid dividends of $1,045 on its $40 million of outstanding variable rate preferred stock in the first half of 1991. This issue was redeemed in the third quarter of 1991.

## LIQUIDITY AND CAPITAL RESOURCES

Following the significant acquisition of natural gas-producing properties by NERCO in 1991, subsequent weakening in late 1991 and early 1992 of gas prices, and continuing turmoil in the financial services markets, two of the Company's three rating agencies, Moody's Investor Service and Standard & Poor's, downgraded the short-term and long-term debt of NERCO, Holdings and the Company in March of 1992. Similarly, a downgrade was made by both rating agencies of the Company's subordinated debt. At June 30, 1992, the senior short-term and long-term debt of the Company was rated P3 and Baa3, respectively, by Moody's and A-3 and BBB-, respectively, by S&P.

As a result of these downgrades, the Company and Holdings have been experiencing restricted access to the commercial paper and medium-term note markets. These markets have historically been the Company's primary source of funding. In order to improve this situation, the Company and Holdings have undergone an extensive review of their financial plans, the purpose of which was to develop a financial plan for each company with the goal of restoring acceptable credit ratings for both companies (see Note 2 to the financial statements). Since the initial announcement of the plan, the Company has generated approximately $75 million of cash through a combination of operations, asset dispositions and nonrecourse financing, such that at June 30, 1992 the Company had a cash balance of $106 million. Based on the results achieved to date, the Company is confident that with the continuing implementation of the plan it will have adequate resources available to meet its current and continuing obligations as they become due.

The total debt-to-equity ratio for the Company at June 30, 1992 was 5.41:1, up from 3.73:1 at December 31, 1991. The recourse debt-to-equity ratio increased to 4.32:1 at June 30, 1992 as compared to 3.07:1 at December 31, 1991, primarily due to the effect of reducing equity balances through the implementation of the Plan.

Management limits the Company's exposure to interest rate fluctuations by match-funding a large portion of its fixed-rate assets with a combination of fixed rate, coterminous liabilities, interest rate swaps and derivative products. The amount of fixed-rate assets not matched by fixed-rate obligations is referred to as the "GAP". It is one of management's objectives to maintain the GAP within +/- 15% of its total assets. This objective was substantially met during the first half of 1992.

The Company has an intercompany loan agreement with Holdings, and during the first half of 1992 has borrowed thereunder. On March 31, 1992, Holdings exchanged the then outstanding $46 million short-term obligation under that agreement for a long-term note of the Company, due March 31, 1994. In addition, a $10 million junior subordinated note held by Holdings was converted to equity. As of June 30, 1992, $46.9 was outstanding from Holdings.

During the first half of 1992, the Company decreased its outstanding short-term debt by $1.6 million. In addition, new long-term recourse debt totalling $2.0 million was issued and $55.2 million matured, resulting in a net decrease in long-term recourse debt of $53.2 million. During the same period, new nonrecourse debt of $66.9 million was issued and $46.0 million matured, resulting in a net increase in nonrecourse debt of $20.9 million.

The Company's usual sources of short-term funds are commercial paper, bank loan programs and committed bank facilities. The Company's committed bank facilities include a $430 million revolving credit agreement dated May 1, 1991 with 26 banks that expires on May 1, 1994, and a $110 million Euro-Credit agreement expiring July 18, 1993. At June 30, 1992, the Company had commercial paper outstanding of $104.2 million and uncommitted bank borrowings of $39.1 million. In addition, the Company had borrowed $390 million as of June 30, 1992 under the committed bank facilities, leaving unused commitments, in excess of outstanding commercial paper, of $45.8 million under the facilities. Subsequent to June 30, 1992, the Company repaid $65 million of borrowings under committed bank facilities, such that, at July 31, 1992 unused commitments in excess of outstanding commercial paper was $99.8 million. The Company's access to short term bank borrowings on an uncommitted basis has been severely restricted. In addition, the Company's commercial paper agent for its local program has suspended its marketing efforts until credit rating improvement is achieved. The Company still has access to the commercial paper markets through its national dealers, albeit on a limited basis experienced by A3/P3 rated issuers.

The Company's primary source of long-term debt has been the public medium-term note markets and term debt with banks. A shelf registration statement covering an aggregate $500 million of public debt securities became effective in November 1991 and periodic offerings of up to $300 million of medium-term notes commenced thereunder. These offerings include senior, senior subordinated and junior subordinated medium-term notes. As of June 30, 1992, a total of $146.2 million of senior notes, $30 million of senior subordinated notes and $21.5 million of junior subordinated notes have been issued since the inception of this offering. (However, only $2.0 million of senior medium-term notes were issued in the first half of 1992.) As a result of PacifiCorp's announced intent to limit the Company's assets to 10% of PacifiCorp's consolidated assets, the Company does not currently anticipate the need for future subordinated debt issuances. The Company's ability to issue public debt has been impaired by the general concern many institutional investors have with the financial services industry, despite the existence of support arrangements from Holdings as described below. The Company's debt covenants restrict the amount of subordinated debt that can be repurchased (see further discussion below).

Holdings has executed various support agreements with the Company in support of the Company's debt and bank facilities. Under the most extensive support agreement provided, Holdings has agreed (i) to maintain ownership of not less than 80% of the voting stock of the Company; (ii) in the event the Company breaches any of its financial covenants requiring the maintenance of tangible net worth as contained in the Company's committed bank credit facilities, such requirement being $167 million at June 30, 1992, to cause, by either a direct or indirect equity contribution to the Company, the tangible net worth of the Company to come into compliance with such financial covenants, and (iii) to provide the Company with liquidity support to enable the Company to fund its debt maturities. These support agreements may be amended or terminated upon satisfaction of certain conditions, including approval or confirmation of the Company's debt ratings from some or all of the rating agencies that rate the debt of the Company. The Company's tangible net worth, as defined by its most restrictive agreement, was $189.9 million at June 30, 1992 or $22.9 million greater than its most restrictive requirement.

The Company's bank credit agreements impose various restrictive covenants on its ability to incur senior and subordinated debt. As of June 30, 1992, after applying the most restrictive of these covenants, the Company could have incurred an additional $532.2 million of senior debt. The Company's bank credit agreements also restrict the Company's ability to declare dividends on its common shares, to effect purchases or redemptions of its common shares, to repurchase or refund subordinated debt or debt securities with a liquidation preference, and to dispose of substantial assets. As of June 30, 1992, as a result of financial adjustments attributable to implementing the Plan, covenants contained in the bank revolver agreements to which the Company is a party prohibited the Company from declaring dividends or making certain other distributions or equity-related payments.

On August 22, 1991, the Company completed the redemption of its outstanding Remarketed Preferred Stock[TM].

PART II. OTHER INFORMATION

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K

None

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PACIFICORP FINANCIAL SERVICES, INC.
(Registrant)

/s/ Donald A. Bloodworth
Donald A. Bloodworth
Vice President and Treasurer

Dated: August 13, 1992